J.W. Burns & Company

Investment Counsel

Quarterly Update - October 2017

Do You Want to Make Money Or Just Sound Smart?

"There are always reasons not to invest, and regrettably for most investor's bottom lines, pessimistic arguments often sound smarter than optimistic ones. The record is in, and despite all the market swoons and bear markets, optimists have triumphed over the long haul." - Daniel P. Wiener, The Independent Advisor Newsletter

"Only pessimism sounds profound. Optimism sounds superficial."
- Teresa Amabile, Harvard Professor

Dear Clients and Friends,

As you know from our frequent client communications, we are a fundamentally driven,

long-term oriented investment counseling firm, with a focus on the underlying earnings power of your portfolio holdings as well as the global economic backdrop. Going back to January 2015, the earnings results from the companies that make up the S&P 500 Index were flat to slightly down for six consecutive quarters. However, since June of last year, the trailing twelve-month S&P 500 earnings are up approximately 10%, while the earnings of corporations in the developed markets of Europe and Japan have increased over 20% on average.[1] This improving global earnings picture explains, in our view, why our current bull market marches on.

Equity markets globally had a superb third quarter despite the pain and wreckage of Hurricanes Harvey and Irma and the bellicose rhetoric between the U.S. and North Korea. For the three months ending September 30, the S&P 500 Index was up 4.48% and international stocks, as measured by the MSCI EAFE Index (Europe, Asia and Far East), were up 5.4%. Year to date, the S&P 500 is up over 14% and EAFE is up a powerful 19.96%. The Lipper Balanced Index is up a strong 10% year to date. Currently, we are very pleased with the performance, both in terms of earnings growth and stock price appreciation, of your quality portfolio holdings.

"The improving global earnings picture explains, in our view, why our current bull market marches on."

It should also be noted that through September 30 the market performance has been driven largely by large-cap stocks, in particular the technology sector with names such as Apple, Amazon, Visa, Microsoft, Google, etc., leading. Indeed, small and mid-cap stocks have lagged, with small-cap value stocks up "only" 5.68% year to date. However, over the last few weeks, we have noticed that value-oriented stocks, both large and small, are picking up steam. More on this later.

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As the opening quote states, it may sound smarter to be bearish, but it rarely pays off. ***Recessions, corrections, and bear markets are part of the investing process, and it is best to be prepared emotionally for this inevitable occurrence.*** However, when I think of all the bearish advisors and naysayers, especially during the first few years of this bull market going back to 2009, up to this point, we have been right by staying essentially fully invested in durable growth equities. We remain bullish, while acknowledging that sharp stock market declines happen – sometimes for no reason at all.

We have been consistent in our message to you, our truly valued clients, throughout 2017. The U.S. economy is healthy and continuing to grow; furthermore, earnings growth has been very robust thus far in 2017. As I mentioned in our July client letter, analyst estimates for the second-quarter S&P 500 companies were for earnings to grow 6.5%; I stated they would easily surpass the forecast, which they did, coming in at almost 10%. International economies are beginning to fire up, and we now have the first synchronized global economic growth since 2011. The Fed remains accommodative, consumer confidence is high and unemployment low. Cash levels remain very elevated, offering more buying power for stocks. As I write this, Larry Fink, CEO of Blackrock, the world's largest asset manager (and not always bullish), stated that "Cash levels remain too high."

Third-quarter earnings season is now ramping up. I expect solid earnings reports, but unlikely to be in the double-digit range that we have seen over the last few quarters. I would guess it would be in the 4-5% range, which is still solid and above analysts' consensus. No doubt, Hurricanes Harvey and Irma will have a negative impact, and comparisons from last October results will be tougher. However, I believe your portfolio companies will do better than 4-5% (obviously on a case by case basis), and overall we like what we are hearing from your companies' management teams.

Tax reform is the issue the market is currently focused on. The Trump administration has released some details and states the tax reform legislation will get done by December 31. I doubt it. Tax reform is tough and complex. Most likely, we will see limited tax cuts, not broad tax reform. Either way, the stock market is not really pricing in successful legislation here, so if it actually gets done, it would be a positive for equities. The key issue is the corporate tax rate, currently at 35%, one of the highest in the world. (This is offset by our relatively low individual tax rates vis-a-vis the rest of the world.) I believe 25% corporate rate is likely, and first quarter of 2018 is the earliest we will see this, if at all.

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Now on to your questions.

Q. You stated earlier that while large-cap tech stocks have been the leaders in 2017, value stocks were beginning to outperform. Explain what that means and how that will affect my portfolio.

A. Value stocks are generally seen as "bargains" or stocks that are inexpensive based on a number of traditional metrics, such as price-to-earnings ratios (P/E ratio), price-to-book value, price-to-sales, etc. There are a number of ways one can define a value stock. Many of these companies can have problems that make the stock inexpensive, but investors are willing to wager the company can turn it around and the stock price will follow. Growth stocks are seen as having more consistent sales and earnings trends, great management teams, and dominant market positions. As such, they are higher quality, but generally more expensive than value stocks.

Warren Buffet has said that growth and value investing is "joined at the hip." They are different, but the objective is the same – ***making money***.

I like the quality, consistency, and relatively lower risk profile the great growth companies provide.

Value stocks, in general, are primarily found in the more cyclical sectors, such as energy, materials, financials, and some consumer discretionary stocks.

The value sectors that we are focusing on and researching are the material and financial stocks. Higher quality material names, such as Praxair, Ecolabs, and AGCO, are of interest to us. In the financial sector, we already have some exposure (KeyBank, J.P. Morgan, XLF, Bank of America), and we are actively researching Investors BankCorp (symbol: ISBC), which serves the high net worth markets of New York and New Jersey and is sitting on over $1 billion in cash – with a market cap of only $4.1 billion. Our team believes it may be materially undervalued. We may visit the company soon.

We are especially keen on the banks because as interest rates rise – which we think is the likely scenario over the next few years – they make more money on the loans they service, so you are likely to see us add positions here.

Understand that here at J.W. Burns & Company, we are constantly researching and assessing various stocks, sectors, and subsectors, working hard to uncover values. We are hounds for information and knowledge.

Q. Were you surprised that the market shrugged off North Korea's increased missiles and escalating rhetoric from both Kim Jong-Un and Donald Trump?

A. Not really. At this time, the potential for any war between the two sides remains a low probability event. It is certainly a possibility as both leaders are unpredictable, so anything could happen. However, war would very likely ensure the annihilation of the Kim Jong-Un dynasty, as well as severe casualties throughout the region.[2] So, I think war is unlikely.

The South Korean stock market has continued to climb, up over 22% year to date, so there apparently is no significant panic there. However, this could be a case of investors simply ignoring the danger because an actual war could have results that are unthinkable – and impossible to forecast. The important takeaway, however, is that stock markets care about global GDP and earnings growth, not short-term geopolitics.[3] And, as I mentioned earlier, global economies and earnings growth is currently accelerating.

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So, as we head into third-quarter earnings season here in October, we are focused on the earnings growth of the broad U.S. market, and, ***far more importantly, the results, tenor, and forward guidance of your portfolio companies.*** We believe that the global economic momentum is positive and cash levels are elevated, which is fuel for further upside in equities. Conversely, stocks are not inexpensive, and geopolitical issues could certainly damage economic growth. A recession or correction can occur at any time. Nevertheless, at this time, 2017 is shaping up to be an excellent year for our clients and optimistic equity investors globally.

Stock market pessimists may sound smart, but over the decades, the ***triumph has belonged to the optimists!***

"Pessimism leads to weakness, optimism to power" – William James.

Best wishes,

Jim

James C. Burns, CFA
President

P.S. - Updated Information: J.W. Burns & Company is moving!

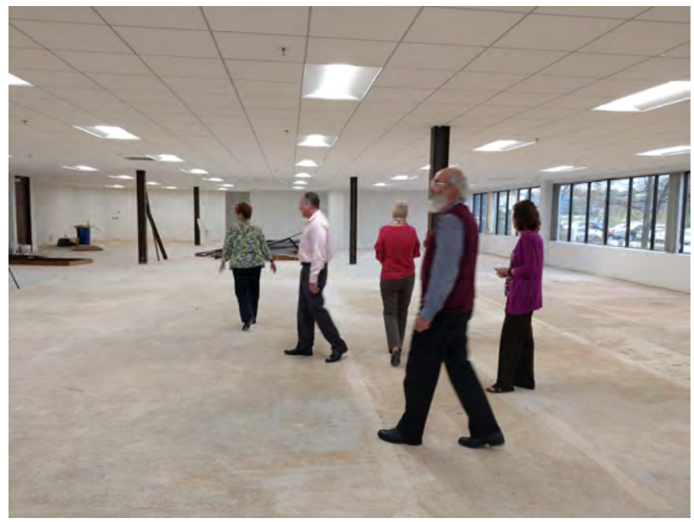
After almost 20 years at Glacier Creek Office Park in East Syracuse, we are moving less than a mile away to a wonderful business park at Widewaters Parkway. Our new address effective January 1, 2018, will be:

J.W. Burns & Company Investment Counsel
5789 Widewaters Parkway
DeWitt, NY 13214

Our phone number and email address will remain the same, and we will keep you up to date on our progress as it unfolds. Below are pictures from October 12 of our new office space before construction began on October 16.

P.S.S. - As you know, I have been running for about five years now; on October 15, I ran in the annual Eastwood 5-mile race, which is a tough, hilly, "real" runners' race. I grew up in Eastwood, and early on in the race, I ran past my old house that I grew up in, as you can see in the picture attached. Better yet, I finished in the top 12% of all runners, and, for the first time, actually won first place in my age category, 50-54 year old. I think that will be my last road race from a successful 2017, as I like going out on top! LOL!

Missing: James Sanderson, Chris Barker



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Important Disclosure Information

1, 2 - Haverford Outlook - Fall 2017

3 - Fisher Investments, Stock Market Outlook, 2017: Part 3